COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF ALBANY GAS UTILITY COMPANY, OF CLINTON COUNTY, KENTUCKY, FOR (1) A CERTIFICATION OF PUBLIC CONVENIENCE AND NECESSITY TO CONSTRUCT AND OPERATE A NEW NATURAL GAS DISTRIBUTION SYSTEM AT ALBANY, KENTUCKY, (2) APPROVAL OF THE PROPOSED PLAN OF FINANCING OF SAID PROJECT AND (3) APPROVAL OF PROPOSED GAS RATES TO BE CHARGED BY THE COMPANY TO THE NATURAL GAS CUSTOMER	)	CASE NO. 9329

O R D E R

On April 29, 1985, Albany Gas Utility Company ("Albany") filed an application for approval of the financing and construction of Phase I and II of a natural gas distribution project for Albany, Kentucky, and environs. The construction will be funded by the stockholders through stock purchases or loans to the corporation. This Phase I and II project is to provide natural gas service to 520 customers in and around Albany. Albany further requested approval of rates for service after completion of construction.

The first two phases of the proposed construction have been designed by Albany to serve the City of Albany and environs; however, proper line size and volume have been incorporated into the design to allow for future additions to the system.

A hearing was held July 16, 1985, in the offices of the Public Service Commission at Frankfort, Kentucky, to consider the application. There were no intervenors, and no protests were entered.

The rates proposed by Albany would produce approximately $625,325 of annual revenues under the assumptions of a projected normalized test period. The rates and charges established by the Commission will produce approximately $400,978 of annual revenues under the same assumptions of the adjusted normalized test period described herein.

TEST PERIOD

This is a proposed rather than an operating utility and test year information does not exist. Estimated pro forma expenses were utilized for the determination of revenue requirements and the rates that should produce the required revenue.

PROJECTED RATE BASE, REVENUES AND EXPENSES

Albany proposed a normalized rate base, normalized revenues and normalized expenses based on varying assumptions of future operating conditions. The Commission is of the opinion that the normalized rate base and the normalized revenues and expenses are generally proper and acceptable for rate-making purposes with the following modifications:

PROJECTED RATE BASE

Albany proposed a projected rate base for normal operations of $450,688 including cash working capital of $41,047 based on 12.5 percent of operating and maintenance expenses less gas purchases.[1] The Commission has determined Albany's rate base as follows:

Utility Plant in Service	$ 571,146
Tap-on Fees	< 62,850>
Depreciation Expense, 1985	< 6,463>
Depreciation Expense, 1986	< 19,670>
Depreciation Expense, 1987	< 25,344>
Depreciation Expense, 1988	< 23,876>
Depreciation Expense, 1989	< 23,698>
Cash Working Capital	16,236
Determined Rate Base	$ 425,481

PROJECTED REVENUES AND EXPENSES

Tap-on Fees

Albany proposed to include as operating revenues $62,850 of tap-on fees accumulated through the construction phases of the gas system scheduled for completion in 1989. The Commission has accounted for the tap-on fees according to the directives of the Uniform System of Accounts for Class C and D Gas Utilities as Contributions in Aid of Construction, which reduces the original cost of plant giving rise to the contribution, and has reduced rate base by the amount of tap-on fees as can be noted earlier herein.

Purchased Gas

Albany proposed annual purchased gas costs of $245,634, based on projected volumes and an average price of $2.35 per Mcf of gas.[2] Albany's current gas contract specifies[3] $1.80 per Mcf

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1 Response to Item No. 2, Commission's First Request.

2 Response to Item No. 7, Note D, Commission's First Request.

3 Application, Contract No. F, April 29, 1985.

cost with a 3 percent escalator clause which takes effect on March 15, 1988.[4] In addition, Albany must pay a $.16 finder's fee on each Mcf of gas.[5]

Based on the current contract price per Mcf of gas, the current finder's fee, the projected normalized Mcf volume of sales (104,525 Mcf), the Commission has determined annual normalized gas purchased cost to be $204,869. Any rate relief Albany requires as a result of escalating gas costs can be granted pursuant to the provisions of a purchased gas adjustment clause. Therefore, the Commission has reduced normalized gas purchased costs by $40,765 annually.

<u>Operating Supplies and Expenses</u>, Account No. 752;
<u>Mains and Services Supplies and Expenses</u>, Account No. 762;
<u>Supplies and Expenses</u>, Account No. 903;
<u>Maintenance of Mains</u>, Account No. 755;
<u>Maintenance of Line</u>, Account No. 767;
<u>Maintenance of Meters and Regulators</u>, Account No. 768;
<u>Maintenance of Other Plant</u>, Account No. 769

Albany proposed the following as normalized annual expenses:

1.	Account No. 752	$4,800
2.	Account No. 762	4,800
3.	Account No. 903	2,400
4.	Account No. 755	4,800
5.	Account No. 767	4,800
6.	Account No. 768	4,800
7.	Account No. 769	4,800

When asked if he thought that these costs would vary proportionally with the number of customers, Mr. Gary Hill,

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4 Application, Contract, Appendix B, line 8, April 29, 1985.

5 Transcript of Evidence ("T.E."), p. 18, July 16, 1985.

President of Albany Gas, stated that these costs would be proportional to the number of customers.[6]

The first incidence of the booking of these expenses occurs in the projected income statement of 1986.[7] This data indicated that the average cost per customer is $3.38 for Account No. 903 expense and $6.76 for each of the remaining classifications. The Commission is of the opinion that the 1986 average cost data is the single best estimate of the per customer expense and has determined 1989 normalized annual expenses based on 447.5 1989 average customers as follows:

1.	Account No. 752	$3,025
2.	Account No. 762	3,025
3.	Account No. 903	1,513
4.	Account No. 755	3,025
5.	Account No. 767	3,025
6.	Account No. 768	3,025
7.	Account No. 769	3,025

Thus, in the aggregate, the Commission has reduced the proposed normalized annual expenses by $11,537 to $19,663 annually.

Wages and Salaries

Albany proposed normalized wages and salaries of $204,902 annually.[8] The wages and salaries were based on the salaries of the three principal stockholders of $46,305 each, three field personnel at $17,365 each, and an office person at $13,892. Wages

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6 T.E., p. 25, July 16, 1985.

7 Response to Item No. 7, Commission's First Request.

8 Response to Item No. 7, Note E, p. 3, Commission's First Request.

and salaries of $32,797 were capitalized in the projected test period. The principal stockholders have excellent credentials[9] with combined high-quality natural gas experience of decades; some have professional licenses; all have done extensive consulting for which they were highly paid.[10]

The Commission is aware that the design and installation of gathering, transmission, and distribution systems, the negotiation of long-term contracts, the organizing of the complex chain of activities and events which result in a viable, safe gas utility demand a very high level of technical and entrepreneurial expertise. However, the design and installation of a new gas system is apart from the normalized operation of a gas system.

The proposed annual amount of normalized wages and salaries does not compare well with other small systems of comparable size under the Commission's jurisdiction in terms of the salary level of the principals, the number of executive positions and the number of field personnel.

Although Albany Gas does not compare favorably to gas utilities of an equivalent size, there are some mitigating factors. Most utilities of Albany's size employ some lower-skill part-time labor which aids and is under the supervision of a full-time field worker. Additionally, most of these small utilities employ outside consultation for necessary legal, accounting and engineering services.

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9 Application dated April 29, 1985.

10 T.E., pp. 26-28, July 16, 1985.

In consideration of the above facts, the Commission has established Albany's wage and salary structure as follows:

1. One president, general manager - $30,000 annually;

2. One bookkeeper, billing clerk, receptionist, customer information specialist - $15,500 annually;

3. One field person, meter reader, maintenance and repair person - $18,000 annually;

4. Various part-time labor to aid field person - $6,000 annually;

5. Outside services - $2,400 annually.

It is the Commission's opinion that the wage and salary structure enumerated above will provide Albany with sufficient quality personnel for on-going normalized operations. Thus, the Commission has reduced the proposed amount of normalized wages and salaries by $100,205 to $71,900 annually.

The Commission hereby advises Albany that the level of salaries approved in this case is for the purpose of establishing an initial rate based on its best estimate of labor needs for a small utility. In future cases for rate-making purposes, the salary levels will be evaluated based on the individuals employed by Albany at that time, and the cost allowed under actual operating conditions may vary from what is allowed herein.

Income Taxes

Albany has elected "Subchapter S" tax status for income tax purposes and, as such, proposed no normalized amount of income tax expense.[11] However, as Albany may elect a tax status other than "Subchapter S" in future periods, a readily available documentation of property subject to investment tax credit may be important in the Commission's future decision making concerning a fair and reasonable amount of income tax expense. The property subject to investment tax credit, the projected in-service dates, and the dollar amount appear in Appendix B to this Order.

Depreciation Expense

Albany Gas proposed normalized depreciation expense of $41,995 based on useful lives of 3 years for used office furniture, 3 years for new and used transportation equipment, 4 years for power-operated equipment, and 20 years for the remainder.[12] The 20-year useful life for the remainder of the utility plant in service was based on the term of a 20-year franchise with the City of Albany, Kentucky.[13] The case record reflects no anticipated difficulty of renewing the franchise with the City of Albany.

The Commission is not aware of an instance when a utility's franchise has not been renewed when the utility provided safe, reliable and cost-effective service to its customers. Therefore, the useful economic life of the depreciable items should control in this case. However, the Commission does realize that additional franchise costs may be incurred at the time of renewal.

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11 Response to Item No. 14, Commission's First Request.

12 Response to Item No. 13, Commission's First Request.

13 T.E., p. 32, July 16, 1985.

Therefore, it is the Commission's experience and expectation that the following useful lives are more appropriate for projected normalized operations:

1. Used office furniture - 3 years;
2. Used transportation equipment - 3 years;
3. New transportation equipment - 5 years;
4. Power-operated equipment - 7 years;
5. Meter stations, odorizing units, residential services, residential meters, residential meter installations - 30 years;
6. House service regulators, house regulator installations, industrial and commercial hook-ups - 20 years;
7. Franchise costs, organizational expenses, miscellaneous intangibles - 20 years;
8. Transmission lines, distribution mains - 40 years.

Based on the above useful lives and the in-service dates and costs of the assets as provided by Albany, the Commission has determined normalized depreciation expenses to be $23,698 annually, or a reduction of $18,297 annually to the proposed amount of depreciation expense.

After consideration of the aforementioned adjustments, and the elimination of $43,772 in bad debts expense and $1,000 in Regulatory Commission expense described later herein, the Commission finds Albany's projected normalized expense of operations as follows:

	Proposed Normalized	Adjustments to Proposed	Adjusted Normalized
Projected Operating Expenses	$574,007	$<218,433>	$355,574

REVENUE REQUIREMENTS

Albany proposed that its revenue requirements be based, in addition to operating expense and rate base, on a 10 percent rate of return on rate base,[14] uncollectible accounts of 7 percent,[15] and $1,000 annually of Regulatory Commission expense.[16]

The Commission's experience with uncollectible accounts among residential and small commercial users is that the percentage of uncollectibles compared to revenues from gas sales is small relative to competitive markets where alternative suppliers are more available. The Commission's experience is that uncollectibles would vary in a normal range of .27 percent to .91 percent for residential and small commercial customers when considering the customer deposit and the necessity of natural gas service. Large commercial and industrial uncollectibles, as well as sales for resale, are typically considered by this Commission on a case-by-case basis, as these accounts tend to be few in number, large in amount, and lack predictability. Therefore, the Commission is of the opinion that a mean uncollectibles expense of .59 percent is a fair and reasonable estimate of uncollectibles for normalized operations.

The Commission has determined Albany's revenue requirements, based on the adjusted normalized rate base herein, the

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14 Response to Item No. 1, Commission's First Request.

15 Response to Item No. 7, Commission's First Request.

16 *Ibid*.

adjusted normalized operation expenses herein, and uncollectibles expense of .59 percent, a Regulatory Commission fee of .115 percent, and a rate of return of 10 percent, as follows:

Adjusted Normalized Rate Base	$425,481
Rate of Return	X .1
	$ 42,548
Total Operating Expenses	355,574
Commission Fee	466
Uncollectibles	2,390
Revenue Requirements	$400,978

PROJECTED AND PROPOSED PRODUCT SUPPLY

The Commission has a vital interest in Albany's gas supply and feels that all the data requested in the data request dated August 12, 1985, must be supplied to the Commission. Further, gas reserves information which is not presently available from the wells that are to supply Albany must be submitted as that information becomes available. Albany should understand that in the event supplies of gas fail to meet requirements of the system, that portion of the system not being served cannot be considered as useful for rate-making purposes.

FINDINGS AND ORDER

The Commission, after consideration of the record and being advised, is of the opinion and finds that:

1. Albany began construction of the system prior to any filing with the Commission, and construction has continued during consideration of the application. The Commission's Engineering Division has reviewed construction as it progressed to insure that it meets applicable codes and construction requirements. Therefore, no purpose could be served by reviewing and approving construction plans and specifications at this time. However, Albany

should be aware that the Commission cannot and will not accept failure to adhere to its filing requirements in the future, and Albany will be required to file "as built" plans on construction that has been completed.

2. Albany should insure that the construction work is done in accordance with the contract plans and specifications and in conformance with the best practices of the construction trades involved in the project.

3. Albany should require the Engineer to furnish a copy of the record plans and a signed statement that the construction has been satisfactorily completed in accordance with the contract plans and specifications within 60 days of the date of substantial completion of this construction.

4. Albany should file with the Commission a copy of all contractual agreements for the provision of services or the purchase of services which are subject to the approval of this Commission.

5. Albany stated in its response received by the Commission on September 6, 1985, that there is no information available from which to provide a reliable reserve analysis of its gas supply; and that as decline curves are obtained on the wells being produced, a reserve analysis will be made and provided to the Commission. Albany also stated that the first analysis will be made within 6 months after the start of production.

6. The rates proposed by Albany would produce revenue in excess of that found reasonable herein and should be denied upon application of KRS 278.030.

7. The rates in Appendix A are fair, just and reasonable rates for Albany in that they will produce gross annual revenues from gas sales of approximately $400,978 which should provide for Albany's operating expenses and provide a sufficient return to its investors.

8. Public convenience and necessity require the construction proposed in the application and record and therefore a certificate of public convenience and necessity should be granted.

IT IS THEREFORE ORDERED that Albany be and it hereby is granted a certificate of public convenience and necessity to proceed with the proposed construction project as set forth in its application.

IT IS FURTHER ORDERED that Albany shall cause its engineer to file certified "as built" drawings with the Commission that reflect the construction that has been completed on Phase I and II within 60 days of completion of the work, but no later than February 15, 1986.

IT IS FURTHER ORDERED that any deviations from the approved construction which could adversely affect service to any customers shall be subject to the prior approval of this Commission.

IT IS FURTHER ORDERED that Albany shall file with the Commission a copy of all contractual agreements for the provision of services or the purchase of services which are subject to the approval of this Commission.

IT IS FURTHER ORDERED that Albany shall supply to the Commission for approval the gas supply and reserves data requested in the data request dated August 12, 1985, as the data becomes available, but in no event longer than 6 months after the beginning of service to Albany.

IT IS FURTHER ORDERED that the rates proposed by Albany be and they hereby are denied.

IT IS FURTHER ORDERED that the rates in Appendix A be and they hereby are approved for service rendered by Albany on and after the date of this Order.

IT IS FURTHER ORDERED that within 90 days of the date of this Order Albany shall file its tariff sheet setting forth the rates approved herein. Further, a copy of Albany's operation rules and regulations shall be filed with its tariff.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 4th day of October, 1985.

PUBLIC SERVICE COMMISSION

Richard D. Heman Jr.

Chairman

Vice Chairman

Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 9329 DATED 10/4/85.

The following rates and charges are prescribed for the customers in the area served by Albany Gas Utility Company. The following rates and charges are to be effective within 20 days of the date of this Order and upon the filing of the tariff with the Kentucky Public Service Commission.

TARIFF

Usage	Rate
0 - 50 Mcf	$3.98 per Mcf
51 - 100 Mcf	$3.88 per Mcf
101 - 250 Mcf	$3.78 per Mcf
251 - 750 Mcf	$3.68 per Mcf
751 - 1500 Mcf	$3.58 per Mcf
1501 - 2500 Mcf	$3.48 per Mcf
Over 2501 Mcf	$3.38 per Mcf

Minimum charge per month will be $3.95.

APPENDIX B

Description	In Service Date	Amount
Property Subject to ITC:		
3-year Used Property	1985	$ 22,533
3-year New Property	1986	20,200
15-year New Public Utility Property	1985	146,066
15-year New Public Utility Property	1986	80,350
7-year New Property	1987	30,000
15-year New Public Utility Property	1987	50,675
15-year New Public Utility Property	1988	37,375
15-year New Public Utility Property	1989	38,847
Property Not Subject to ITC:		
Organizational and Franchise Costs		82,250
Tap-on Fees		62,850
		$571,146